

**LINKING FORMAL AND INFORMAL FINANCIAL ARRANGEMENTS:
A NOTE FROM THE GAMBIA**

by

Geetha Nagarajan,

and

Richard L. Meyer

April 1995

Rural Finance Program
Department of Agricultural Economics
The Ohio State University
2120 Fyffe Road
Columbus, Ohio 43210-1099

Abstract

This paper describes a NGO program in The Gambia designed to link indigenous groups called RoSCAs with formal financial institutions. The careful institutional design of the NGO seems to be an improvement over the indigenous informal financial arrangements and the linkages with formal banks is found to be advantageous in providing financial services to women entrepreneurs.

LINKING FORMAL AND INFORMAL FINANCIAL ARRANGEMENTS EVIDENCE FROM THE PERI-URBAN GAMBIA

by

Geetha Nagarajan and Richard L. Meyer

Formal financial institutions have been inefficient in providing services in many developing countries due to high transaction costs in lending that arise due in part to incomplete information about borrowers. Therefore, informal financial arrangements that have informational advantages have been observed to emerge, flourish and provide valuable services. Informal arrangements, unlike formal financial institutions, are less able to finance long-term projects, diversify portfolios across wide geographic regions and customers, and integrate markets. Linking formal with informal arrangements, therefore, has often been suggested to take advantage of both the formal and informal financial technologies for better financial intermediation (Adams and Ghate, 1992, Seibal, 1985).

NGOs are perceived to be an effective means to link formal and informal arrangements (Nwanna, 1994; Seibel and Parhusip, 1992). Several NGOs, therefore, are attempting to link these financial arrangements by: (i) directly intervening into existing informal arrangements to provide financial services through them, or (ii) creating and utilizing new informal arrangements for financial services, or (iii) playing a catalytic role by linking formal and existing informal arrangements. While several NGO attempts to link formal and informal arrangements have failed (Abugre, 1993), there are a few successful cases. This paper describes an experiment by a national NGO called Women in Service, Development, Organization and Management (WISDOM) in The Gambia to organize informal rotating savings and credit groups called osusus among women microentrepreneurs and link them with formal financial institutions. In The Gambia, traditional osusus are formed by the members themselves while NGO osusus are organized by NGOs. The members of an osusu, either NGO or traditional, agree to contribute a fixed amount of cash and/or goods into a common fund or pot at regular intervals and the pot is then allotted to one member (sometimes more) in turn, based upon some previously agreed criteria. Each member contributes a fixed amount at each turn or rotation and receives the pot once until the entire cycle is completed; then the group may disband or the cycle may recommence with the same or a different set of members and terms and conditions. This paper first describes WISDOM's approach in creating and linking osusus with banks for improved financial intermediation. This is followed by a discussion of the implications of the WISDOM approach using case studies conducted in peri-urban Gambia among 24 fruit and vegetable retailers during March 1993.

Linking Formal and Informal Arrangements: The WISDOM Approach

WISDOM is a national NGO started in 1989 to: (i) provide technical skills and functional literacy to women microentrepreneurs and farmers; (ii) create awareness about gender issues; and (iii) organize women into osusus and strengthen these groups to become viable financial institutions. By 1993, WISDOM covered about 300 villages in the country serving 9,000 members.

The financial services including short and long term credit and deposit mobilization are channelled through banks called Wisdom Indigenous Loans and Savings Societies (WILSS). The flow of services through WILSS is presented in figure 1. While loans are available only to WISDOM osusu members primarily comprised of women, deposit services are provided to both men and women nonmembers. Four branches of WILSS were established in 1992 in the urban and peri-urban areas of Banjul, Njau, Bansang and Soma. Although WISDOM supervises these WILSS, they are managed by village committees formed by WISDOM osusu members.

WISDOM has so far organized about 400 osusus in various parts of the country. Of this total, 130 osusus with about 3,000 women operate in Banjul and the surrounding peri-urban areas. Each osusu is managed by a committee comprised of president, vice-president, secretary and treasurer. The osusus generally consist of about 20-30 occupationally heterogenous women residing and/or working in close geographic proximity. The members periodically contribute a fixed amount to a common pot that rotates among them until every one has received the pot once. The member who receives the pot contributes about five percent to a group contingency fund and pays an administration fee to WISDOM for organizing the osusus. A WISDOM official is usually present on every pot allocation day to collect the administration fee and the contingency fund. The contingency fund is deposited in the osusu account maintained at WILSS and is used to give emergency loans to members during mid-rotation periods and to smooth out short-falls that arise due to member delinquencies because of income fluctuations.

In addition to organizing osusus, WILSS also provide individual loans to their members based on the recommendations of the village committees formed by WISDOM osusu members. The village committees screen borrowers and serve as guarantors to their members to obtain individual production loans. WILSS has so far made loans to about 300 individual participants in some 200 WISDOM osusus. The loans range in size from D 200 to 3,000 with an average of D 1,000 for a period of six to eight months.¹ The annual interest rates are fixed at 24 percent irrespective of the project financed. The inflation rate at the time of survey was about nine percent. Individuals with regular income can guarantee member loans or half the savings of the member or member's group can be used as collateral. The borrower cannot withdraw her savings until the loan is repaid. The loans are partially financed through grants from OXFAM, an international donor, and regular deposits mobilized from members and their osusus, and

¹ 1 \$U.S = 8.2 Dalassis.

nonmembers. As of 1993, the share of donors was nine percent, while that of member deposits (groups and individuals) was 72 percent and nonmember deposits were 19 percent of the total volume of funds lent out.

The WILSS mobilize regular deposits from both individuals and osusus. There is a minimum deposit requirement of D 50 and individual members are eligible to borrow at least twice the amount of their savings as production loans. An annual interest of 12 percent is paid on deposits. Most of the mobilized savings have been invested in Treasury bills that earn about 18 percent per annum. Slowly, WILSS have begun to lend some of these savings on short term loans (four months) to women member microentrepreneurs. In addition to regular deposit services available for individuals and osusus, the osusus are further allowed to deposit their contingency funds and osusu funds collected prior to pot allotment at WILSS. These contingency funds also earn a 12 percent annual interest rate. However, the osusu funds rarely earned much interest since the lag between the collection and allocation of osusu funds was usually less than a week.

By linking osusus and individuals with WILSS, the WISDOM provides the following functions: (i) stimulates member and nonmember savings and help these small savers realize higher treasury bill rates, (ii) provides insurance to osusu members through contingency funds, (iii) utilizes saver's funds to provide loans, and (iv) leverages individual loans to members through member, nonmember and donor funds. Therefore, WISDOM provides financial services beyond those available through indigenous osusus.

The following sections examine the role of WISDOM among market vendors in peri-urban Gambia and analyzes how the approach has affected financial intermediation compared to traditional osusus.

Description of the Sample

The primary participants for WISDOM in urban areas are women market vendors. Therefore, we selected 24 women vendors of fruits and vegetables at random in two urban retail markets, Banjul and Bakau, and interviewed them using a structured questionnaire during March 1993.² Tables 1 and 2 present the sample characteristics and the nature of financial transactions reported by the sampled vendors participating in traditional and WISDOM osusus.

Enterprise Characteristics and Financial Transactions

The majority of the sampled vendors operated in an organized market place by renting table or floor space from the urban council. On average, a vendor sold four different products including cabbage, tomatoes, onions, potatoes, lettuce, spinach, egg-plants, okra, bitter tomatoes,

² Nearly 95 percent of the vendors in the market are women and 65 percent of them sell fruits and vegetables.

peppers, chilies, bananas and mangoes. Generally, they did not produce the commodities they traded but procured from local producers, wholesalers, middle-(wo)men and fellow-vendors depending on the prices offered. A majority of their purchases from suppliers were effected through spot market transactions involving immediate cash payment. Consignment contracts and long-term relationships with suppliers were seldom reported. About 11 percent of the vendors reported paying their suppliers in advance, especially Senegalese suppliers of bananas, mangoes and peppers. About 29 percent of the vendors were able to obtain short-term supplier's credit from wholesalers in the same market for a period of one to two weeks. The loan sizes ranged between D 60 to 9,000 with an average of about D 650 and with no explicit interest charges.

The clients for these vendors included local Gambians, expatriates, hotel suppliers, fellow-vendors from other markets and, to a lesser extent, hotels and restaurants. The majority of the clients were irregular so most of the transactions involved immediate cash payments. About 20 percent of their transactions were with regular buyers including smaller traders from other markets and hotel suppliers. Some of these regular buyers were sold products including mangoes, onions, potatoes and tomatoes on short-term credit for one to three weeks. The amount of these credits ranged from D 55 to 5,500 with an average loan size of about D 850. An implicit monthly interest of 10 to 30 percent was charged. No advance payments were required from the clients.

The majority of the vendors' trading activities were self financed. Formal loans were not available but 21 percent reported informal loans from friends and relatives and eight percent reported loans from kafos.³ Informal finance for these largely women vendors was available through widespread participation in osusus. Nearly 75 percent of the sample participated in at least one osusu, either a traditional one or one organized by WISDOM, that usually functioned within the market among traders who work in close proximity and have daily contact with each other. Osusu funds were reported to be used for financing short-term working capital needs (Table 1).

Only four percent of the vendors had deposits in formal banks. Osusus, kafos and moneykeepers supplied substitutes for formal deposit mobilization services.⁴ Nearly 25 percent participated in kafos that performed rotating and non-rotating savings and credit functions, while 75 percent participated in osusus. The deposit services provided by WILSS of WISDOM were

³ Kafos are informal but strong and cohesive village groups that are multifunctional in nature. They perform several functions including insurance, financial intermediation, labor and socio-political services. Like osusus, they are homogenous in terms of member's age, ethnicity, heritage, gender and occupation but have various membership sizes with an average of about 108 persons (see Nagarajan, Meyer and Ouattara, 1994 for details).

⁴ Moneykeepers are individuals who hold savings on behalf of others. Often no interest is paid on these savings but the moneykeeper may be expected to make emergency loans to frequent savers.

used by 21 percent of the sample. Only 13 percent reported using moneykeepers to hold their excess funds (Table 1).

Participation in Osusus

Table 2 provides the key features of the WISDOM and traditional osusus in which the vendors participated. While 42 percent were members of WISDOM osusus, 33 percent participated in traditional osusus. Over 80 percent of the WISDOM osusu members were participants of traditional osusus prior to joining WISDOM. The WISDOM requirement of exclusive participation in its osusus prevented several traditional osusu members from simultaneously participating in WISDOM osusus.

The WISDOM and traditional osusus were generally small and headed by women. They functioned through out the year although they tend to be less important during the months of April to October which is the slack season in the production and marketing of fruits and vegetables. While the members were reported to be homogeneous in gender, place of residence and work place in the WISDOM osusus, they were homogenous only in occupation and work place in traditional osusus. The average pot size in WISDOM osusus was higher than in the traditional ones. On average, the savings were collected every four and one days and the pots were allocated every six and eight days in the traditional and WISDOM osusus, respectively. Whereas the lottery method was the only method used to allocate funds in WISDOM osusus, the traditional osusus allocated their funds according to requests from members or some order fixed at the beginning of the osusu cycle.⁵ A contingency fund is found in WISDOM osusus but not in traditional osusus.⁶ While WISDOM membership offers its members an opportunity to have individual savings accounts and obtain individual loans from WILSS, the loans made by the traditional osusus are limited by their fund size.

Does the WISDOM Approach Improve Financial Services for Vendors?

The financial intermediation provided by WISDOM through links with WILSS' banks was reported by the vendors to be a desirable feature. The osusu funds deposited with WILSS earn interest and also function as collateral for osusu members. Two out of the ten WISDOM osusu members in the sample obtained short-term loans from WILSS to expand their businesses. Furthermore, the banking experience gained through participation in WILSS was reported to help members shed their inhibitions toward banks and encouraged regular banking habits.

⁵ The order was fixed according to the order in which the members were recruited or by age or by the number of new members recruited by an existing member.

⁶ Traditional osusus often met member contingencies by holding special collections.

The benefits obtained through the inclusion of occupationally diverse members in the WISDOM osusus are likely to outweigh the benefits associated with occupationally homogenous traditional osusus. This is true because a region specific risk may have a differential impact on members engaged in several types of income generating activities. Therefore, region specific shocks such as crop failures have a smaller effect in an osusu composed of occupationally heterogenous members. The lucky members can co-insure the unlucky members in a cohesive osusu which consists of members bounded by moral obligations. Furthermore, little information is lost through this type of diversification since all members reside and/or work in close proximity to each other. Furthermore, since the WILSS are somewhat geographically dispersed, the funds are recycled across regions through bank transfers so that the needs of deficit and surplus units can be matched.

The inclusion of contingency funds in WISDOM osusus was reported to help meet member short-falls due to delinquencies and needs for contingency loans during mid-rotation. Furthermore, since the contingency fund is located at WILSS, it can be used as collateral to obtain member loans from WILSS. These features provide insurance to members and thereby increase the incentives for members to continue membership in the osusu. Indeed, of the ten respondents who participate in WISDOM osusus, only one was a member for less than six months; the others had participated in multiple rotations. The contingency fund also increases the stake of the members in the osusu because it represents their joint savings.⁷

WISDOM is also cautious in extending external assistance to the individual osusus. Although it organizes the osusus and provides technical assistance in their operations such as bookkeeping, it does not inject a substantial volume of external funds into them. The objective of encouraging osusus to function with self-generated funds is well protected. For these several reasons, the advantages of the WISDOM osusus over the traditional ones appear to provide important benefits for the members and may be sustainable over the long run.

Conclusions and Policy Implications

NGOs are becoming increasingly active in providing financial services in developing countries and several are attempting to link formal with informal arrangements to improve financial intermediation. This paper describes an approach followed by a national NGO in The Gambia that organizes informal rotating savings and credit groups and links them with NGO banks for improved financial services. The NGO mimics indigenous informal groups by forming groups that are small and fairly homogenous in membership composition. But it also offers opportunities for members to save and borrow from NGO banks as an individual using the group as a guarantee. Also the formation of a group contingency fund serves as collateral for a group member to obtain individual loans from the bank and helps smooth out fluctuations in pot allocation due to member

⁷ This feature is a replication of the Grameen Bank approach in Bangladesh where it has been successfully used to reduce delinquency problems.

delinquencies. These features are observed to improve financial intermediation and are preferred by several women market vendors interviewed.

There are limitations to the WISDOM approach, however. First, these osusus are organized by an external agency. They are provided with technical assistance regarding operational techniques and are linked with NGO banks. It is not clear if these osusus will continue to function using the same model once the external technical assistance from WISDOM in organizing osusus and linking them to WILSS is phased out. Nor is it clear if commercial banks will be enthusiastic to follow the WISDOM model and link with informal arrangements. Second, WISDOM members incur higher administration costs compared to members of traditional osusus since the maintenance of records on transactions involves some paper work. Third, while heterogeneity among members can facilitate risk diversification, a mismatch in preferences/interests of the osusu members can lead to unsustainability of the osusus. Therefore, while possibilities exist to replicate the general design of the WISDOM approach in other parts of Africa, caution is needed in designing osusus so that they synchronize well with member requirements. Our conclusions are supportive of Abugre (1993) who suggested that NGOs should identify and understand informal financial arrangements to build upon them rather than rush to set up parallel systems.

Figure 1 Flows of Funds: WISDOM Indigenous Lending and Saving Societies (WILSS)

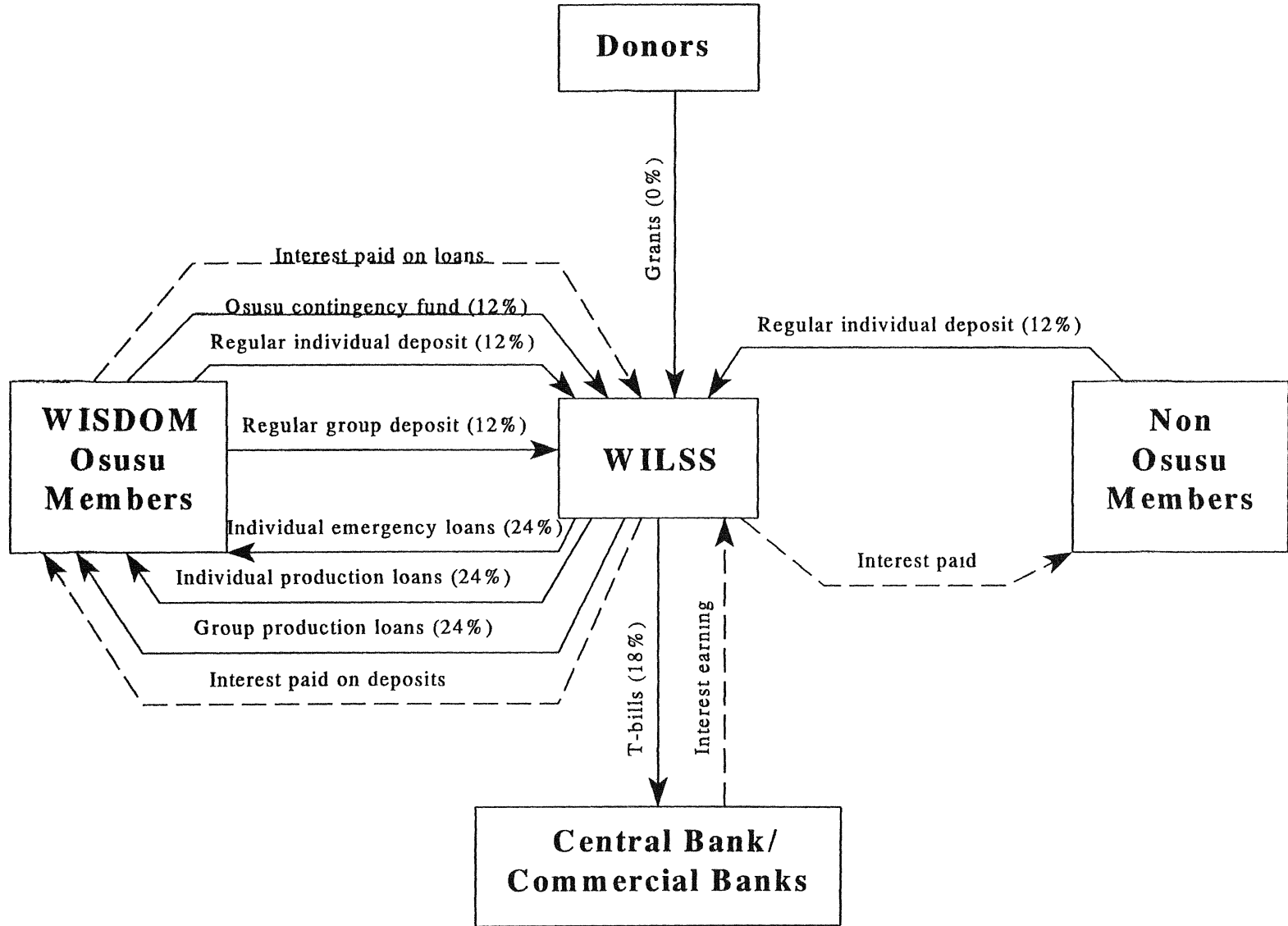


Table 1. General Characteristics and Financial Transactions of the Sampled Fruits and Vegetable Vendors, 1993.

Items	Number (percent) reporting
1. Sample Size	24
2. Number of Borrowers ¹ :	
a. Formal banks	0 (0)
b. WILSS (WISDOM Bank)	2 (8)
c. Friends and relatives	5 (21)
d. Money lenders	0 (0)
e. Produce suppliers	7 (29)
f. Kafos ²	2 (8)
g. Traditional osusus	8 (33)
h. WISDOM osusus	10 (42)
3. Number of savers:	
a. Formal banks	1 (4)
b. WILSS (WISDOM Bank)	5 (21)
c. Kafos	6 (25)
d. Moneykeepers	3 (13)

1 Number may not add up due to multiple borrowings.

2 Only six out of the 24 respondents participated in kafos.

Table 2. Selected Features of WISDOM and Traditional Osusus

Item	WISDOM osusus	Traditional osusus
1. Number participating	10	8
2. Average membership size	26	23
3. Percent of women members to total members	100	93
4. Member characteristics	Homogenous in gender, work place and place of residence; less homogenous in occupation and age.	Homogenous in occupation and work place; less homogenous in gender, age and place of residence.
5. Average pot size (dalassis) ¹	1,450	535
6. Average frequency for collecting savings (days)	1	4
7. Average frequency of pot allocation (days)	8	6
8. Pot allocation method (by order of importance)	Lottery	Request, Order and lottery
9. Contingency fund	Present	Absent
10. Individual savings and loan services	Present	Absent

1 One \$ U.S. = 8.2 Dalassis.

REFERENCES

- Abugre, Charles, "When Credit is not Due: Financial Services by NGOs in Africa," Small Enterprise Development, Vol. 4, No. 4, 1993, pp. 24-33.
- Adams, Dale W and P. B. Gbate, "Where to From Here in Informal Finance?" in Informal Finance in Low-Income Countries, Dale W Adams and Delbert A. Fitchett (eds.), Boulder: Westview Press, 1992, pp. 349-360.
- Nagarajan, Geetha, Richard L. Meyer and Korotoumou Ouattara, "Financial Intermediation by NGOs: Implications for Indigenous Village Groups in the Gambia," Savings and Development, Vol. 18, No. 2, 1994, pp. 211-224.
- Nwanna, Gladson I., "Forging Collaboration Between Formal and Informal Financial Markets: Some Thoughts," Savings and Development, Vol. 18, No. 3, 1994, pp. 323-333.
- Seibel, Hans D., "Savings for Development: A Linkage Model for informal and Formal Financial Markets," Quarterly Journal of International Agriculture, Vol. 24, No. 4, 1985, pp. 390-398.
- Seibel, Hans, D. and Uben Parhusip, "Linking Formal and Informal Finance: An Indonesian Model," in Informal Finance in Low-Income Countries, Dale W Adams and Delbert A. Fitchett (eds.), Boulder: Westview Press, 1992, pp. 239-248.

